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No. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

PORTLAND GENERAL ELECTRIC COMPANY,
Petitioner,

v.

MONTANA DEPARTMENT OF REVENUE, et al.,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE MONTANA SUPREME COURT

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QUESTIONS PRESENTED

1. May the State of Montana constitutionally impose beneficial-use ad valorem property taxes upon a shareholder-owned utility, whose retail customers are located exclusively outside the State of Montana, for its alleged "use" of federal electric power transmission facilities in Montana when such transmission facilities are owned, operated, maintained, possessed, and controlled exclusively by the Bonneville Power Administration ("BPA"), a federal power marketing agency?

2. May the State of Montana constitutionally impose beneficial-use ad valorem property taxes upon such a utility for its alleged use of federal electric power transmission facilities located in the State of Montana, but at the same time refuse to impose such beneficial-use taxes upon Montana rural electric cooperative utilities that receive indistinguishable transmission services from BPA and whose retail electric customers are all located within Montana?

3. May the State of Montana constitutionally impose beneficial-use ad valorem property taxes on federal electric power transmission facilities of 500kV and over, which high-voltage facilities are designed and operated to transmit large blocks of power in interstate commerce, but at the same time exempt from such taxes lower-voltage federal transmission facilities designed and used to transmit lesser amounts of power over shorter distances?

4. May the State of Montana constitutionally impose beneficial-use ad valorem property taxes upon those it has determined to be users of federal electric power transmission facilities, but at the same time exempt users of property owned by the State of Montana from such beneficial-use taxes?

5. In imposing beneficial-use ad valorem property taxes upon federal transmission facilities, may the State of Montana constitutionally determine the amount of such taxes based upon assumptions (1) that all of the power transmitted flows over taxable high-voltage federal transmission facilities and that, therefore, none flows over tax-exempt lower voltage transmission facilities and (2) that the major value or benefit from the existence of a bidirectional transmission line results from the ability of the line to export power from the state?

PARTIES BELOW

Portland General Electric Company[1] was the only plaintiff below. Defendants below, in addition to the Montana Department of Revenue, were: Mineral County; Billye Ann Bricker, Treasurer of Mineral County; Sanders County; June M. Thayer, Treasurer of Sanders County; and Ed Argenbright, Superintendent of Public Instruction. All of the defendants were represented by counsel for the Montana Department of Revenue.

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[1]PGE is a wholly owned subsidiary of Portland General Corporation, an Oregon corporation. Other wholly owned subsidiaries of Portland General Corporation are Miracle Mine Operations, Inc. and Portland General Holdings, Inc. All of the following enterprises are affiliated with PGE as direct or indirect subsidiaries of Portland General Holdings, Inc.: Portland General Energy Systems, Inc.; Portland General Exchange, Inc.; World Trade Center Northwest Corporation; Portland General Financial Services, Inc.; Columbia-Willamette Development Company; Columbia-Willamette Investment Company; Portland General Leasing, Inc.; Columbia-Willamette Leasing, Inc.; Cornerstone Columbia Development Company; FFP, Inc.; Frontier First Partners; and Rail Leasing, Inc.

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PORTLAND GENERAL ELECTRIC COMPANY,
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v.

MONTANA DEPARTMENT OF REVENUE, et al.,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE MONTANA SUPREME COURT

Portland General Electric Company ("PGE") petitions this Court for a writ of certiorari to the Montana Supreme Court to review the opinion in *Portland General Electric Company v. Montana Department of Revenue*, ___ Mont. ___,773 P.2d 1189 (1989). The opinion is reprinted at 21a of the Appendix.

OPINIONS BELOW

The order of the District Court for Lewis and Clark County, Montana, is unreported and is reprinted at 13a of the Appendix. The opinion of the Montana Supreme Court is reported at ___ Mont. ___, 773 P.2d 1189, and is reprinted at 21a. A related case involving additional utility plaintiffs and different federal 500-kV transmission facilities was also decided by an order of the District Court for Lewis and Clark County, Montana. *See Pacific Power & Light Company v. Montana Department of Revenue*, ___ Mont. ___, 773 P.2d 1176 (1989) *("Pacific Power")*. The order in the *Pacific Power* case is unreported and is reprinted at 29a of the Appendix. All of the evidence received in the *Pacific Power* case was entered into the

record in this proceeding by stipulation approved by the trial court.[2] The trial court's order in the *Pacific Power* case was also appealed to and affirmed by the Montana Supreme Court, which decision is reported at ____ Mont. ____, 773 P.2d 1176, and is reprinted at 51a. A petition for rehearing in that case was timely filed with the Montana Supreme Court, which petition was denied on June 1, 1989.

JURISDICTION

The Opinion of the Montana Supreme Court was issued on May 10, 1989. Petitioner PGE did not petition for rehearing. Under United States Supreme Court Rule 20.2 and 28 U.S.C. § 2101(c) (1982), a petition for certiorari is due on August 8, 1989. Jurisdiction rests on 28 U.S.C. § 1257 (1982), as amended by Pub. L. No. 100-352, § 3, 102 Stat. 662 (1988).

STATEMENT OF THE CASE

A. The Facts.

The basic facts are not in dispute. Congress has directed the Bonneville Power Administration ("BPA") to construct, own, operate, and maintain a major federal electric transmission grid called the Federal Columbia River Transmission System ("FCRTS") to serve several important federal purposes.[3] Those purposes specifically include the integration and transmission of "electric power from existing or additional Federal or non-Federal generating units" located both within and without the Pacific Northwest.[4] Pursuant to this congressional authority, in 1973 BPA constructed, and today BPA operates, maintains and controls, a federal 500-kV transmission line from BPA's Hot Springs substation in northwestern Montana to the Idaho border.

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[2] References to the transcript in the *Pacific Power* case are designated by the word "Incorporated" appearing before the transcript citation. Thus, a citation to transcript page 77 of the *Pacific Power* case would appear in this Petition as "Incorporated Tr. 77." The name of the witness providing the testimony follows the citation.

[3] *See* the Bonneville Project Act, 16 U.S.C. § 832 (1982); the Pacific Northwest Federal Transmission System Act, 16 U.S.C. § 838 (1982).

[4] 16 U.S.C. § 838b (1982).

Many years after BPA's Hot Springs-Idaho border 500-kV transmission facilities were first placed in commercial operation, five Northwest utilities[5] decided to construct and operate Colstrip Units 3 and 4, two new coal-fired steam electric generating plants to be located in southeastern Montana, where the coal was located. Pursuant to congressional authorization, the utilities contracted for BPA to transmit the power from the new Colstrip plants to their service areas to the west. For PGE, BPA delivers power to a substation near Portland, Oregon. Under the BPA transmission contract, PGE has no right to own, operate, maintain, possess, or even have physical access to the transmission facilities for which PGE has been taxed by the State of Montana. Indeed, PGE's nearest personnnel and equipment are more than 300 miles from the transmission line.

B. The Proceedings in State District Court.

The Montana Department of Revenue ("Department of Revenue" or "Department") notified PGE that it was taxing PGE for its alleged use of BPA's Hot Springs-Idaho border 500-kV transmission facilities. PGE challenged that action by filing a lawsuit in the Montana District Court for Lewis and Clark County in Helena. PGE's complaint specified that the Department's imposition of beneficial-use taxes violated, inter alia, the Supremacy Clause, the Commerce Clause, and the fourteenth amendment. In a non-jury trial, three witnesses testified and numerous documents, transcripts, and exhibits were admitted. On January 19, 1988, the District Court issued an order upholding the taxes. *See* 13a of the Appendix.

C. The Montana Supreme Court Decision

PGE timely appealed to the Montana Supreme Court which affirmed. *See* 21a. No petition for rehearing was filed.

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[5]Those utilities are Portland General Electric Company, which serves customers located in Oregon; Pacific Power & Light Company, which serves retail electric customers in six western states; The Washington Water Power Company, which serves retail electric customers in Washington and Idaho; Puget Sound Power & Light Company, which serves retail customers in Washington; and the Montana Power Company, which serves retail customers located in Montana and Yellowstone Park, Wyoming.

REASONS FOR GRANTING THE WRIT

Montana's imposition of beneficial-use taxes upon PGE violates three fundamental federal constitutional provisions — the Supremacy Clause,[6] the Commerce Clause,[7] and the fourteenth amendment. In 1981, this Court upheld a Montana severance tax on coal mined from federal land in Montana and shipped to electric utilities in the Midwest. *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981) (*"Commonwealth Edison"*). Now Montana seeks to further broaden its "tollhouse" taxes. It seeks to tax alleged use by Northwest utilities of federally owned and operated instrumentalities of commerce — BPA's major electric transmission facilities between Hot Springs, Montana and the Idaho border.

While this case involves Commerce Clause issues similar to those considered by this Court in *Commonwealth Edison*, it also involves an effort by Montana to tax the "use" of federal property. If Montana's effort succeeds, the states "may tax the mail; they may tax the mint." *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 432 (1819) *("M'Culloch")*. The critical issue here thus arises under the Supremacy Clause: May the states tax alleged use of federal instrumentalities (here, the BPA electric grid; next, perhaps, the interstate highway system)? Is it consistent with the Supremacy Clause for the states to tax an alleged use of a federal instrumentality which was designed and built with federal funds, and which is possessed and controlled exclusively by a federal agency in order to serve a broad federal purpose?

At the outset, this Court should consider two important factors that have influenced this and related litigation over the last five years. Those factors are (1) the immense precedential impact that the challenged Montana Supreme Court decision will have if allowed to stand and (2) the overall circumstances surrounding the litigation in Montana State courts. Each factor strongly supports issuance of the requested writ.

A. Background Factors Supporting Issuance of the Writ.

There are two interrelated background factors that support is-

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[6]Article VI, clause 2 of the United States Constitution.

[7]Article I, section 8, clause 3 of the United States Constitution.

suance of the writ. The first is that the Montana beneficial-use experiment is being watched closely by other states in the Pacific Northwest. For example, measures were introduced in both the 1987 and 1989 Oregon Legislative Assemblies that would have imposed beneficial-use taxes upon federal transmission facilities located in the state. The 1989 measure was forestalled, doubtless in hope that this Court would resolve the serious constitutional questions created by Montana's experiment, saving both Oregon and its potential taxpayers the enormous sums necessary to adjudicate such a controversy. An expansion of Montana-style beneficial-use taxes could have a profound effect upon each utility's operations, its power marketing activities, and ultimately perhaps BPA's own power marketing activities.

The second background factor supporting issuance of the writ involves simple fairness. The issue of whether the State of Montana may tax foreign investor-owned utilities for their alleged use of BPA 500-kV facilities has sparked intense public interest throughout Montana. The most important consideration is economic: If Montana's unprecedented imposition of beneficial-use taxes on federal transmission facilities is not set aside, the many millions of dollars the investor-owned utilities have paid under protest now being held in escrow accounts will be released to the local taxing districts. Understandably, from the earliest days strong sentiments in favor of imposition of the tax have frequently been voiced. *See, e.g.*, Minutes of Montana House Taxation Committee (Mar. 1, 1983).

A common remark often heard in legislative halls is, "The best tax is the one the other guy pays." Normally, the first line of defense against unjust taxation is the ballot box: Persons unfairly targeted by legislators can vote their pocketbooks. That protection, however, is simply not available to PGE nor, for that matter, to most other taxpayers who have paid beneficial-use taxes on federal transmission lines. PGE's customers all reside in Oregon and therefore have no representative in Montana legislative halls, nor can they participate in the elections for Montana's district court and supreme court judges. PGE's complete political disenfranchisement suggests strongly that the writ should be issued. Moreover, this Court is the only federal court available in this matter to protect national in-

terests and the interests of other states' citizens, for the Tax Injunction Act denies PGE access to federal district courts. 28 U.S.C. § 1341 (1982). Finally, the Montana Supreme Court was not entirely unfamiliar with the controversy before it was presented on appeal — Montana Supreme Court Chief Justice Turnage in 1983 was both State Senator Turnage and a member of the 1983 Montana Senate Revenue Committee, which committee reported out the amendments to Mont. Code Ann. § 15-24-1203 that led to imposition of the challenged beneficial-use taxes on PGE. All of these factors suggest that PGE has yet to have its federal constitutional challenges addressed by a neutral body.

B. The Supremacy Clause: Both the Doctrine of Implied Preemption and the Doctrine of Express Preemption Invalidate Montana's Imposition of Beneficial-Use Taxes on Federal High-Voltage Transmission Facilities.

PGE's challenge involves two Supremacy Clause issues, one of "implied preemption" arising under Chief Justice Marshall's historic *M'Culloch* opinion, and the second arising under an express statute designed to prevent discrimination against interstate transmission of electric power, the Anti-Discrimination Act.[5] Each of these Supremacy Clause challenges is discussed below.

1. Under *M'Culloch v. Maryland,* Beneficial-Use Taxes May Not Be Imposed on Account of Federal Property Unless the Taxpayer Possesses and Controls the Facilities Subject to the Tax.

As is established below, the State of Montana has taken an utterly unprecedented approach to state taxation of federal instrumentalities. Neither *M'Culloch* nor the cases decided under it have ever been interpreted to authorize imposition of beneficial-use taxes upon a private party that does not possess the federal facilities upon which the taxes are based. Furthermore, in the instant case PGE is not even allowed physical access to BPA's Hot Springs-Idaho border 500-kV transmission facilities; only BPA operates, maintains, and controls those facilities.

If Montana's imposition of beneficial-use taxes on PGE is allowed

[5] 15 U.S.C. § 391 (1982).

to stand, nothing would prevent a state from taxing a private person for his alleged use of federal postal facilities used to deliver the mail, federal hydroelectric projects that generate power for consumption by industrial and residential users of power, or numerous other federal instrumentalities possessed by the government and employed in providing a vast array of services to citizens of the United States. The raw, uncontested facts establish that Montana's tax is indeed both unique and dangerous.

In *M'Culloch*, Chief Justice Marshall pointed out the mischief that would be caused by state taxation of federal instrumentalities:

> If the States may tax one instrument, employed by the government in the execution of its powers, they may tax any and every other instrument. They may tax the mail; they may tax the mint; they may tax patent rights; they may tax the papers of the custom-house; they may tax judicial process; they may tax all the means employed by the government, to an excess which would defeat all the ends of government. This was not intended by the American people. They did not design to make their government dependent on the States.
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> ....The question is, in truth, a question of supremacy; and *if the right of the States to tax the means employed by the general government be conceded, the declaration that the constitution, and the laws made in pursuance thereof, shall be the supreme law of the land, is empty and unmeaning declamation.*

Id. at 432-33 (emphasis added). Quite simply, instrumentalities actively used by the federal government may not be subjected to state taxation.

PGE does not contend that federal property possessed, occupied, and controlled by a private taxpayer may not be subjected to state property taxation; *see Baltimore Shipbuilding and Dry Dock Co. v. Baltimore*, 195 U.S. 375 (1904) (states may tax private interests in federal property). Still, *M'Culloch's* bright-line distinction remains: States are powerless to tax federal property which is exclusively in the hands of federal officials. Thus, in *Mayo v. United States*, 319 U.S. 441 (1943), this Court upheld an injunction against a state's

enforcement of a statute calling for the regulation and imposition of fees upon fertilizer owned by the Untied States. *Mayo's* significance results from its holding that when the United States itself is carrying on an activity upon which the state attempts to impose a tax, congressional silence is not to be construed as consent to such taxation:

> But where, as here, the governmental action is carried on by the United States itself and Congress does not affirmatively declare its instrumentalities or property subject to regulation or taxation, the inherent freedom [from taxation] continues.

Id. at 448.[9]

During World War II this Court issued a decision in a situation closely analogous to the present one. In *United States v. County of Allegheny*, 322 U.S. 174 (1944) *("Allegheny")*, Justice Jackson first summarized the history of immunity from state taxation:

> But unshaken, rarely questioned, and indeed not questioned in this case, is the principle that possessions, institutions, and activities of the Federal Government itself in the absence of express congressional consent are not subject to any form of state taxation.

Id. at 177. The Court implemented Justice Jackson's rationale by voiding a state tax upon property owned by the United States. However, the Court did note that federal property *in the possession of a private taxpayer* might be subjected to state taxation: "[The taxpayer] is a bailee for mutual benefit. Whether such a right of *possession and use* in view of all the circumstances could be taxed by appropriate proceedings we do not decide." *Id.* at 186 (emphasis added).

Decisions subsequent to *Allegheny* developed the notion that the value of a taxpayer's possessory interest in property could be taxed by the state, so long as there was no attempt to tax the

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[9]In light of *Mayo*, it is interesting to note that in 1980 Montana's congressional delegation attempted but failed to obtain congressional consent to the taxing of BPA high voltage transmission facilities in Montana. Minutes of Montana House Taxation Committee at 3 (Jan. 21, 1981).

federal value. For example, in *United States v. Detroit*, 355 U.S. 466 (1958), this Court upheld a tax upon a lessee of federal property who had both possession and physical use of the federal property. *Id.* at 470. And in *United States v. Muskegon*, 355 U.S. 484 (1958), a state tax upon a permittee who was in actual possession of a manufacturing plant owned by the United States was upheld. *Detroit v. Murray Corporation*, 355 U.S. 489 (1958), further developed the requirement of a possessory interest under the *M'Culloch* line of cases:

> We see no essential difference so far as constitutional tax immunity is concerned between taxing a person *for using property he possesses* and taxing him *for possessing property he uses* when in both instances he uses the property for his own private ends. Nor have we been pointed to anything else which would bar a State from taxing possession in such circumstances. *Lawful possession of property is a valuable right when the possessor can use it for his own personal benefit.*

Id. at 493 (citation omitted; emphasis added).[10]

Lower federal courts have interpreted the *M'Culloch* line of cases to preclude taxation of federal property in analogous situations. Most recently, the Sixth Circuit affirmed a federal district court's determination that a state could not impose property taxes on a contractor who operates and maintains federal munitions facilities. *United States v. Hawkins County, Tennesse*, 859 F.2d 20 (6th Cir. 1988), *cert. denied*, 109 S.Ct. 1638 (1989) And only last

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[10]See Keesling, "Property Taxation of Leases and Other Limited Interests," 47 *Calif. L. Rev.* 470, 487-92 (1959), which indicates that the property tax can be imposed *only if* the taxpayer has both possession and use of the property.

The most recent Court decision in the *M'Culloch* line is *United States v. County of Fresno*, 429 U.S. 452 (1977), in which a California county had imposed an annual tax on private taxpayers' possessory leasehold interests in government-supplied housing. After reviewing recent cases, this Court returned to *M'Culloch's* first principles, *viz.*, that federal functions and interests not be discriminated against. To determine the validity of the tax, this Court looked to three factors: 1) its legal incidence, (2) whether it was applied in a discriminatory manner, and (3) whether it was based on the total value of the federal interest or only the value of the taxpayers' possessory interest in the property. These three issues are addressed in the subsequent portion of this Petition.

year, in *United States v. Jackson County, Missouri,* 696 F.Supp. 479 (W.D. Mo. 1988), the federal district court held that Bendix, which had agreed with the United States government to manage, operate, and maintain a federal munitions facility, could not be taxed for similar alleged use of those facilities. In reaching this holding, the court discussed this Court's 1958 beneficial-use cases, as well as *United States v. County of Fresno,* 429 U.S. 452 (1977), and concluded that because Bendix lacked exclusive possession of the facilities the tax could not validly be imposed under Missouri law.[11].

State court decisions also support the restriction of the state's taxing power to federal property which the taxpayer possesses and occupies. For example, in *Thiokol Chem. Corp. v. Morris County Bd. of Taxation,* 41 N.J. 405, 197 A.2d 176 (1964), the New Jersey Supreme Court voided a tax on federal contractors because their interests did not constitute a lease. While the issue there involved the question of state statutes, the court noted in its opinion, "Of course, property owned and in possession of the United States would not be taxable." *Id.* at 410, 197 A.2d at 181. Finally, in *Cutter Flying Serv., Inc. v. Property Tax Dep't,* 91 N.M. 215, 572 P.2d 943 (1977), the court held that a license to use exempt property does not subject property to taxation.

2. The Anti-Discrimination Act Prohibits Taxes that Even Indirectly Discriminate Against Interstate Commerce in Electricity.

The Montana tax is explicitly preempted by Section 2121(a) of the Tax Reform Act of 1976, 15 U.S.C. § 391 (1982) ("Anti-Discrimination Act"). Federal law is not just silent, it affirmatively precludes such state taxation. The Anti-Discrimination Act provides:

> No State, or political subdivision thereof, may impose or assess a tax on or with respect to the generation or transmission of electricity which discriminates against

[11]By no stretch of the imagination can PGE's "use" of the Hot Springs-Idaho border line be deemed "exclusive"; many entities enjoy some benefit from the existence of the Hot Springs-Idaho border line.

> out-of-State manufacturers, producers, wholesalers, retailers, or consumers of that electricity. For purposes of this section a tax is discriminatory if it results, either directly or indirectly, in a greater tax burden on electricity which is generated and transmitted in interstate commerce than on electricity which is generated and transmitted in intrastate commerce.

The Anti-Discrimination Act was applied in *Arizona Pub. Serv. Co. v. Snead*, 441 U.S. 141 (1979), in which the unanimous Court invalidated a New Mexico tax upon the privilege of generating electricity within the state because out-of-state electricity users bore a greater burden than in-state users. The Court held, "Because the electrical energy tax *itself* indirectly but necessarily discriminates against electricity sold outside New Mexico, it violates the federal statute." *Id.* at 150 (emphasis in original; footnote omitted). Of particular import is the Court's holding that even *indirect* discrimination against out-of-state users is prohibited by the statute:[12] State taxation is invalid under the Anti-Discrimination Act if those located beyond the borders of the taxing state bear, either directly or indirectly, greater burdens than those within the taxing state. Here, the evidence of both direct and indirect discrimination is overwhelming.[13]

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[12]The Nevada Supreme Court also relied upon the Anti-Discrimination Act in declaring invalid a Nevada tax upon power generated at Hoover Dam. *State v. Burbank*, 100 Nev. 598, 691 P.2d 845 (1984).

[13]There is a second "express preemption" basis for invalidating the challenged taxes: The "impact aid" provisions of the Pacific Northwest Electric Power Planning and Conservation Act of 1980, 16 U.S.C. § 839e(m) (1982). That federal statute authorizes BPA to reimburse local taxing districts for all direct economic consequences resulting from construction and operation of new federal high-voltage transmission facilities located within the districts. The impact-aid provisions were enacted as a direct response to Montana's attempt to persuade Congress to allow imposition of taxes directly upon federal transmission facilities. *See* Montana House Taxation Committee Minutes at 3 (Jan. 21, 1981). Congress appears to have intended that the impact-aid provisions would be the sole basis for local taxing districts to derive revenues on account of federal transmission facilities. To date, BPA has paid over $460,000 in impact-aid payments to Montana local taxing districts. Incorporated Tr. 522 (Eskridge). However, because the Hot Springs-Idaho border line was already in operation when the impact-aid provisions were enacted, no impact-aid payments may be made on account of the Hot Springs-Idaho border BPA line.

C. The Commerce Clause: Montana's Beneficial-Use Taxes on Federal Transmission Facilities Discriminate Against Interstate Commerce in Electricity.

The challenged taxes violate the Commerce Clause. Critical to the functioning of the federal system is that states not inflict disproportionate burdens upon interstate commerce. Very recently this Court in a unanimous opinion, *New Energy Co. of Indiana v. Limbach*, ___ U.S. ___, 108 S. Ct. 1803 (1988), emphatically recited the protections afforded by the "negative implications" in the Commerce Clause:

> This "negative" aspect of the Commerce Clause prohibits economic protectionism – that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors. Thus, state statutes that clearly discriminate against interstate commerce are routinely struck down, unless the discrimination is demonstrably justified by a valid factor unrelated to economic protectionism.

Id. at ___, 108 S.Ct. at 1807 (footnotes and citations omitted).

In *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977) *("Brady")*, this Court reviewed past Commerce Clause decisions and noted that state taxes have been sustained against

> Commerce Clause challenge when the tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State.

Id. at 279. It is critical to note that the state must meet *each* of these four criteria; violation of even one criterion will invalidate the challenged tax.

It is difficult to perceive how the tax on PGE can meet the first requirement, nexus. PGE has no taxable relationship at all with the defendant counties. PGE conducts no business activities whatsoever within hundreds of miles of northwestern Montana. It owns no property located there, and none of its many employees reside

there. The *sole* link between PGE and the defendant counties is an electric transmission agreement between PGE and BPA under which BPA employs the entire, undifferentiated FCRTS to transmit power to PGE. The Hot Springs-Idaho border transmission line is only a small part of the FCRTS. These circumstances establish that the tax simply cannot meet *Brady's* nexus requirement.[14]

The unusual basis for imposing taxes in this case also calls into question whether the tax has been fairly apportioned and whether it is fairly related to services the local taxing districts provide to PGE. Aspects of the fair-apportionment and fair-relation criteria are discussed in the context of succeeding portions of this Petition. This leaves the most important criterion, discrimination against interstate commerce.

Perhaps the best introductory statement of the problem of discriminatory taxes under the Commerce Clause is in Professor Hartman's seminal treatise, *Federal Limitations on State and Local Taxation*. Professor Hartman states:

> "Discrimination" is not a self-defining term. It can be a delusively simple term, and once the question goes beyond the tax that is patently discriminatory on its face, much room for controversy about hidden discrimination exists. While purporting to treat local commerce and interstate commerce alike, if the practical operation of the tax gives local business a competitive advantage over interstate business, it will be branded as unconstitutionally discriminatory. In short, a tax may be nondiscriminatory on the face, but the effect may be discriminatory. The [United States Supreme] Court has frequently found it necessary to probe beneath the face of the statute to expose its discriminatory nature and effect.

P. Hartman, *Federal Limitations on State and Local Taxation* § 2:19 at 122-23 (1981). The following portions of this Petition establish (1) that the Montana statutory scheme regarding bene-

[14]The nexus issue also arises under the fourteenth amendment and, accordingly, is discussed in that portion of this Petition also.

ficial-use taxes has been crafted with a clear intent to discriminate against both interstate commerce and those with whom the United States contracts, (2) that the legislative history behind Montana's beneficial-use statute, Mont. Code Ann. § 15-24-1203 (1987), reflects both a realization that there would be discrimination against interstate commerce *and* an intention that such discrimination occur, and (3) that the Montana Department of Revenue has implemented the beneficial-use statute in a manner purposefully discriminatory against interstate commerce.

1. The Montana Statutory Scheme Discriminates Against Interstate Commerce.

There are at least four unambiguous provisions in the text of the Montana property tax statutes that establish a clear legislative intent to discriminate against both interstate commerce and those with whom the United States deals. Each of those four instances is discussed below.

a. Limiting the Tax to Transmission Facilities of 500 kV and Higher Discriminates Against Interstate Commerce.

Montana's discrimination against interstate commerce is manifest in the very text of the 1983 statutory amendment authorizing taxation of BPA transmission facilities. That amendment provides:

> The tax shall be imposed upon the possession or other beneficial use of an electric transmission line and associated facilities, except that lines and facilities of a design capacity of less than 500 kilovolts shall not be subject to the tax.

Understanding the significance of Montana's limitation to 500-kV transmission facilities requires a brief digression into electric power transmission theory and practice.

First, regardless of intentions or human agreements, power will flow over a transmission system freely, constrained solely by the laws of physics. It is impossible to specify which generating unit's power is going over a specific line to serve a particular customer or customers. Incorporated Tr. 41-46 (Porter); Plaintiff's Exhibit

21. Moreover, transmission lines are bidirectional, *i.e.*, they can be used to transmit power either direction. Incorporated Tr. 64 (Porter). Thus, the line running between Hot Springs and the Idaho border may carry power from Montana on one day and power into Montana on the next.

Mr. Dennis Porter, BPA's transmission engineering expert, testified that high-voltage transmission lines are employed to transmit power over long distances, while lower voltage lines generally are used for shorter distance transmission and local distribution purposes. It is generally conceded that high-capacity lines include lines of 230 kV and above. Mr. Porter also testified that the highest capacity alternating-current lines in service in the Western United States are 500 kV; those lines are capable of transmitting approximately 4.7 times the power 230-kV lines can transmit. Incorporated Tr. 57 (Porter).

By restricting the tax to the highest of the high-voltage lines — those of 500 kV and over — the Montana Legislature intended to, and did in fact, inflict a disproportionate economic burden on transmission facilities that have the greatest impact upon interstate commerce. The lines singled out for taxation are the arteries of interstate commerce in electricity.

b. Montana's Tax Classification Scheme Establishes and Intent to Discriminate Against Out-of-State Consumers of Electric Power.

The second example of the Montana Legislature's express purpose to discriminate against interstate commerce can easily be seen in several Montana statutes that address classification of property for ad valorem tax purposes. Montana assigns various types of property to different classifications, each classification having a different tax "rate" or percentage of market value. Understanding fully how Montana's property tax classification scheme discriminates against interstate commerce requires some background.

There are basically only two types of electric utilities in the State of Montana, *viz.* investor-owned utilities (such as

PGE) on the one hand and rural electric cooperatives on the other. The vast majority of the customers of investor-owned utilities operating in Montana reside in states other than Montana; PGE, whose entire retail customer base is located in western Oregon, is a prime example. In contrast, the customers of Montana rural electric cooperatives are all located exclusively *within* Montana. In addition, all rural electric cooperatives in western Montana, the area containing the Hot Springs-Idaho border lines, are "preference" customers of BPA, which means that they have preference access for *all* of their power needs from the BPA generation and transmission system, which system includes the Hot Springs-Idaho border lines. With this in mind, it should be clear that, in order to create a disproportionate burden on interstate commerce by exporting local taxes, all the Montana Legislature need do is favor rural electric cooperatives' property in relation to property owned by investor-owned utilities such as PGE. This is precisely what the Montana Legislature accomplishes through its property classification scheme.

One need compare only two property tax classification statutes in order to perceive how Montana has discriminated against interstate commerce. Those two statutes are Mont. Code Ann. § 15-6-135 and Mont. Code Ann. § 15-6-141 (1987). The former statute sets the tax rate for rural electric cooperative property ("class five property") at 3 percent of true cash value, while the latter statute sets the tax rate for investor-owned utility property ("class eleven property") at 12 percent of true cash value. Thus PGE pays *four times* the property taxes that a rural electric cooperative would pay for an *identical* piece of property.

c. The Montana Legislature's Intent to Inflict Disproportionate Economic Burdens on Interstate Commerce on Account of the Federal Transmission Facilities Is Manifest in Its 1981 Amendment to Mont. Code Ann. § 15-6-141.

The third textual example of Montana's discriminatory intent is contained in the Legislature's 1981 amendment to Mont. Code Ann. § 15-6-141, which contains the definition of class eleven property. In light of the Department's explicit admission that Montana rural electric cooperatives do in fact use the BPA transmission system,[15] one must wonder how those rural electric cooperatives have escaped beneficial-use taxation. One possible explanation is in the 1981 amendment to Mont. Code Ann. § 15-6-141(a), set forth below:

> (a) centrally assessed electric power companies' allocations, *including, if congress passes legislation that allows the state to tax property owned by an agency created by congress to transmit or distribute electrical energy, allocations of properties constructed, owned, or operated by a public agency created by the congress to transmit or distribute electric energy produced at privately owned generating facilities (not including rural electric cooperatives).*

Of course, the damning phrase is contained in the parentheses: "(not including rural electric cooperatives)." The discriminatory intent in that phrase becomes all the more apparent when the statutory property classification for Montana rural electric cooperatives is examined; under Mont. Code Ann. § 15-6-135(1)(a) (1987), such property is taxable only if it is "used *and owned by* cooperative rural electrical...associations organized under the laws of Montana...."

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[15] *See* Department of Revenue Brief to Montana Supreme Court at 33-34 (Nov. 10, 1988), discussed *infra*.

(Emphasis added.) In this manner the Legislature has precluded classifying federal property used by Montana rural electric cooperatives as class four property. It is difficult to imagine a more blatant attempt to export taxes!

d. Montana's Exemption of Users of State-Owned Property from Beneficial-Use Taxes Discriminates Against Those With Whom the Federal Government Contracts.

The last sentence of the beneficial-use statute, added in 1987,[16] exempts from beneficial-use taxation any taxpayer who uses *state*-owned railroad property. Specifically, the recent amendment removes beneficial-use taxes from persons or entities who use state-owned railroad tracks and rights-of-way so long as such persons or entitites use the property exclusively for railroad purposes. The record in this case establishes that the exemption was carefully crafted to protect those with whom the state contracts for use of state-owned property. Because the Montana Legislature has provided no similar exemptions for users of federally owned property, the beneficial-use statute runs afoul of this Court's recent decision affirming *United States v. Manassas, Virginia*, 830 F.2d 530 (4th Cir. 1987), *aff'd*, 108 S.Ct. 1568 (1988) *("Manassas")*.

In *Manassas*, Virginia's beneficial-use tax statute had been crafted to exempt from taxation certain property owned by state and local governmental units. Virginia s imposed beneficial-use taxes on a private taxpayer who had admittedly used federal property to perform services for the United States. The taxes were challenged on constitutional grounds, inter alia, that the tax discriminated against those who contract with the federal government.

The court of appeals asserted that the dispositive precendent is *Phillips Chem. Co. v. Dumas Indep. School Dist.*, 361 U.S. 376 (1960) *("Phillips")*, which held that beneficial-use taxes that discriminate against users of federal property are unconstitutional. Based on *Phillips*, the court struck down the Virginia tax because of the exemptions for property owned by state and local governments,

[16]Ch. 591, Montana Laws 1987.

reasoning that the state treated those who use state property better than those who use federal property. 830 F.2d at 534. As noted above, this Court affirmed *Manassas* only last year.

The Montana tax scheme cannot survive under the *Phillips* and *Manassas* analysis. Not only is the amount of tax imposed upon PGE disproportionate to any conceivable alleged use of the Hot Springs-Idaho border facilities (a point established *infra*), but also the beneficial-use tax statute treats those who contract with the federal government worse than those who contract with the state. On this basis alone the Montana beneficial-use statute should be struck down.

In summary, the Montana statutory scheme is infected with at least four separate provisions that reflect a clear intent to discriminate against both interstate commerce and those with whom the federal government deals. The Montana Legislature very recently reinforced this intent by exempting state-owned railroad property from taxation, even though such taxpayers (unlike PGE) may have exclusive use, possession and control of the tax-exempt property. For each of these four reasons, the Montana statutory scheme regarding implementation of beneficial-use taxes is unconstitutional on its face.

2. The Legislative History Behind the 1983 Amendment to Montana's Beneficial-Use Statutes Establishes an Intent to Discriminate Against Out-of-State Consumers of Electric Power.

The legislative history behind the 1983 amendment to Mont. Code Ann. § 15-24-1203 establishes conclusively that the Montana Legislature *intended* to discriminate against interstate commerce by exempting from taxation the lower voltage federal transmission facilities used primarily to serve Montana consumers. For example, in the Minutes of the Meeting of the Montana House Taxation Committee dated March 1, 1983, Representative Marks, the sponsor of the legislation, asserted, "If the privilege tax [on BPA 500-kV lines] is applied, a large amount of that tax would be picked up by consumers outside of the State of Montana." Minutes at 4. After the bill had passed the Montana House, Rep-

resentative Marks presented it to the Senate Revenue Committee, where he introduced the measure by urging that its scope should be restricted to 500-kV facilities. He noted the obvious: "If you get below 500-kV [lines]...you could include smaller lines and REAs [rural electric cooperatives]." Minutes of Montana Senate Taxation Committee at 2 (Mar. 25, 1983). Moreover, the record of the Senate deliberations testifies to a similar desire to discriminate. For example, Senator Towe urged that the bill be passed on the grounds that "other power companies [than Pacific and Montana Power, both of which serve Montana customers] will pay 85% [of the tax] and will pass that cost on to their customers in Washington and Oregon." *Id.*[17] These clear indications of discriminatory intent — a hope to protect local enterprises at the expense of out-of-state consumers — buttress the conclusion that the Montana legislation runs afoul of both the Commerce Clause and the Anti-Discrimination Act.

3. The Beneficial-Use Statute is Being Applied by the Department of Revenue in a Manner that Inflicts Disproportionate Burdens upon Out-of-State Consumers of Electric Power.

The foregoing portions of this Petition establish that Mont. Code Ann. § 15-24-1203 (1987), was designed to discriminate against interstate commerce. For its part, the Department of Revenue has more than merely implemented the legislative purpose; it has applied the legislation in a manner that is almost punitive. Three specific shortcomings in the Department's application of the statute are set forth below.

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[17]Also in the Senate Revenue Committee, Senator Turnage (now Montana Supreme Court Chief Justice Turnage, who voted to uphold the imposition of beneficial-use taxes on PGE), spoke in favor of the measure. Minutes of Senate Taxation Committee at 4 (Mar. 29, 1983).

a. The Department of Revenue Has Failed to Impose Beneficial-Use Taxes upon Montana Rural Electric Cooperatives that the Department Openly Admits "Use" BPA Transmission Facilities.

The first example of the Department's discriminatory implementation of beneficial-use taxes is that the Department has yet to impose any beneficial-use taxes on Montana rural electric cooperatives, notwithstanding that the Department is concession that such preference customers do in fact use the Montana BPA transmission system. Department of Revenue Brief to Montana Supreme Court at 33-34 (Nov. 10, 1988). Nothing in the text of Mont. Code Ann. § 15-24-1203 (1987), limits the scope of the statute for 500-kV transmission-line taxes to investor-owned utilities; nonetheless, the Department has targeted *only* such utilities — to the exclusion of Montana rural electric cooperatives.

The record establishes that Montana rural electric cooperatives benefit from the existence of the FCRTS. For example, Mr. Porter of BPA stated that power delivered to Montana REA preference customers is scheduled across the entire BPA system, which of course includes the Hot Springs-Idaho border facilities. Incorporated Tr. 190-91. And BPA's Montana representative, George Eskridge, testified that power from the Columbia River power system would come over a variety of paths, including the Hot Springs-Idaho border 500-kV system. Incorporated Tr. 491. Indeed, in BPA contracts for provision of that power, Hot Springs is one of only three locations for further delivery to Montana preference customers. Mr. Eskridge further testified that power arriving at Hot Springs for consumption in Montana would necessarily have come over the 500-kV facilities. Incorporated Tr. 492.

In spite of many clear indications that Montana rural electric cooperatives derive significant benefit from the federal transmission facilities, the Department of Revenue failed even to investigate whether Montana rural electric cooperatives should be subjected to the beneficial-use tax. As early as 1984 the Department was informed that discrimination against interstate commerce existed on

account of the Department's refusal to tax BPA preference customers for their analogous "use" of the BPA transmission system. However, the Department of Revenue had not even asked by the time of trial to examine contracts between BPA a[illegible] Montana rural electric cooperatives. Incorporated Tr. 918-19 (Whittinghill). The Department's failure even to investigate is damning proof of an intent to inflict a disproportionate economic burden on interstate commerce.

b. The Department's Assumption that All Power BPA Transmits to PGE Must Go Over 500-kV Facilities, and that Therefore None of that Power Goes over Tax-Exempt Lower-Voltage Main Grid Facilities, Results in Inflicting a Disproportionate Tax Burden on PGE's Oregon Customers.

The second example of discriminatory implementation of the beneficial-use tax was elicited from the Department's appraiser. During her testimony she admitted that she calculated PGE's alleged use based upon the assumption that 100 percent of the power transferred west of BPA's Garrison substation went over BPA's 500-kV system and, therefore, assumed that none went over the tax-exempt 230-kV system. Tr. 269 (Whittinghill). More specifically, she noted (1) that BPA was obligated to transmit 65 megawatts ("MW") of PGE's power west of Garrison in 1985, and (2) that the east-to-west capacity of the Hot Springs-Idaho border BPA 500-kV transmission line is 1300 MW. In determining the amount of taxes due, the Department's appraiser testified that she multiplied a fraction times the depreciated cost of the Hot Spring-Idaho border line. That fraction was simply 65 MW over 1300 MW, indicating that all PGE power flowing west of Garrison had to go over the Hot Springs-Idaho border facilities and *none* over the many tax-exempt BPA 230-kV facilities. *Id.* This approach to taxation is clearly at odds with all of the expert engineering testimony in the record to the effect that power will flow over all interconnected lines, not just 500-kV facilities. Had the Department taken tax-exempt facilities into account, it would have produced a far lower taxable value. Once again, the Department's administrative approach inflicts a disproportionate tax burden upon PGE's Oregon customers.

c. The Department's Failure to Recognize the Value of West-to-East Transfer Capability on the Hot Springs-Idaho Border BPA 500-kV Facilities Results in Disproportionate Taxes Being Imposed on PGE.

It is undisputed that BPA's Hot Springs-Idaho border 500-kV transmission facilities are used to transmit power from west to east as well as from east to west. Indeed, the Department of Revenue's own Exhibit 6C establishes that during the assessment year power was actually flowing *into* Montana over the lines, a consequence that certainly must be considered beneficial to Montana citizens. The Department's appraisal approach, however, assumes that the *sole* value of the Hot Springs-Idaho border line stems from its ability to export power from Montana. The Department of Revenue's appraiser testified that, to determine taxable value, she took the total *one*-directional capacity of the line (1300 MW), and used that number as the denominator of a fraction. The numerator of the fraction is 65 MW, which is the amount of power BPA has agreed to transmit over its main grid west of its main grid west of its Garrison substation pursuant to Exhibit D of the BPA transmission agreement, Plaintiff's Exhibit 14; Tr. 246-47, 250-51 (Whittinghill). This fraction (65/1300) reduces to 1/20, which is five percent. The Department of Revenue multiplied that five percent figure times the full depreciated cost of the Hot Springs-Idaho border facilites.

A simple example illustrates the error in the Department of Revenue's approach. Assume that BPA has one contract for transmitting 1300 MW from east to west over the Hot Springs-Idaho border facilities and another contract for transmitting 1300 MW from west to east.[18] The engineering testimony and power-flow studies in the record establish that such an occurrence is certainly physically possible; indeed, it is likely that the power flows in such a situation would cancel one another. However, if the Department of Revenue's approach were used, the tax imposed upon

[18]This example is for illustrative purposes only; as indicated above, certainly much less than all of the power transmitted over BPA's main grid west of Garrison substation would *not* flow over the Hot Spring-Idaho border facilities.

those "users" of the transmission facilities under such contracts would be *two times* the amount of taxes otherwise due from a private party owning the entire facilities outright. Thus by failing to consider the value contained in the bidirectional capacity of the transmission facilities, the Department of Revenue discriminated against those who allegedly use federal transmission facilities.

D. The Fourteenth Amendment: Montana's Imposition of Beneficial-Use Taxes on Federal High-Voltage Transmission Facilities Violates the Due Process and Equal Protection Clauses.

Both the due Process Clause and the Equal Protection Clause of the fourteenth amendment apply to this controversy. Briefly, the Due Process Clause involves questions of restraint and proportionality, while the Equal Protection Clause measures whether persons similarly situated are treated equally. Moreover, the fourteenth amendment challenge in some aspects parallels the Commerce Clause challenge and, thus, the facts in the record alluded to in the Commerce Clause portion of this Petition are equally applicable here.

Under the Due Process Clause, there is an insufficient nexus between PGE and the Hot Springs-Idaho border facilities to allow imposition of the challenged taxes. As this Court stated, the question is

> whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return.

Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940). *See also Norfolk & Western Railway Co. v. Missouri State Tax Commission*, 390 U.S. 317 (1968) (invalidation of taxes that were not related closely of the value of the property interest being taxed). Of particular significance here is the fact that PGE has absolutely no right of access to any portion of the property being taxed; indeed, as noted previously, BPA is not required to employ the Hot Springs-Idaho border facilities in providing transmission services to PGE. Moreover, PGE's own nearest facilities are hundreds of miles dis-

tant. In sum, there is simply not sufficient nexus between PGE and the Hot Springs-Idaho border facilities to justify the Department's imposition of taxes.

The Equal Protection challenge is based upon the Department's refusal even to consider treating taxpayers similarly situated equally. Unequal administration of tax laws has long been a basis for invoking the Equal Protection Clause. *Raymond v. Chicago Union Traction Co.*, 207 U.S. 20 (1907). The Department's utter failure even to investigate whether Mont. Code Ann. § 15-24-1203 should be imposed upon Montana rural electric cooperatives' use of the federal 500-kV Hot Springs-Idaho border facilities employed by BPA to deliver power to the cooperatives is perhaps the most flagrant example possible of both discriminatory intentions and consequences.

Finally, the Department of Revenue has inflicted an unequal burden. In the long history of the Department's administration of Mont. Code Ann. § 15-24-1203 the Department has always required (1) physical possession of the otherwise tax-exempt facilities coupled with (2) exclusive use of the property in order to trigger tax liability. In the instant situation, the Department has required *neither*. Accordingly, the Department's conduct violates the Equal Protection Clause of the fourteenth amendment.

E. Conclusion.

A writ of certiorari should issue to the Montana Supreme Court.

Respectfully submitted,

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